

RECEIVED

MAR 31 2006

Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Request for Review by
ILD Telecommunications, Inc. and
Intellicall Operator Services, Inc.

of Decision of the
Universal Service Administrator

)
)
) CC Docket Nos. 96-45 and 97-21
)
)
)

) USAC Audit Report No. CR2004CP019
)
)

REQUEST FOR REVIEW

March 31, 2006

Timothy J. Fitzgibbon
Nelson Mullins Riley & Scarborough, L.L.P.
101 Constitution Avenue, NW.
Suite 900
Washington, D.C. 20001
(202) 712-2800

Counsel for ILD Telecommunications, Inc. and
Intellicall Operator Services, Inc.

TABLE OF CONTENTS

SUMMARY	i
FACTUAL BACKGROUND	2
ARGUMENT	6
I. Certain USAC Audit Procedures Are Inconsistent With FCC Rules And Violate Administrative Due Process	9
A. USAC Still Has Not Served Intellicall with a Copy of the Final Audit Report	9
B. USAC Demanded Representation Letters From Intellicall That Were Inaccurate and Improper	10
C. USAC Unilaterally Established Artificial Deadlines During the Audit Process	12
II. USAC-IAD Made Improper Substantive Interpretations And Policy Decisions In Conducting The Audit	13
A. USAC-IAD Audited ILD Without Receiving The Guidance It Sought From The FCC	14
B. The Instructions to Form 499-A And USAC-IAD's Interpretation of Them Discriminate Against Carriers Using Accrual Accounting	17
1. Disparate Treatment of Bad Debt	18
2. Disparate Treatment of Prompt Payment Discounts	18
C. USAC-IAD's Interpretations Require Intellicall to Contribute to USF on the Basis of Non-Telecommunications and Intrastate Revenues.	19
1. Computer Data Storage And Maintenance	20
2. Breakage	22
3. Contra Taxes	23
4. Zero-Plus Revenue Issues	24
5. USF Contribution Revenue	26
D. The LIRE Exception and USAC's Application of It Are Competitively Harmful and Discriminatory	26

E.	Wholesale Unbundled Revenue Issues.....	27
F.	Conference Service Revenue Issues.....	30
G.	One Plus Revenue Issues	31
	1. Amounts Unpaid by Resellers.....	31
	2. PICC Charges	32
III.	Delegation of the Audit Function to USAC Without Established Procedures or Guidelines Is Improper	33
A.	USAC's Role As Administrator Violates the Government Corporation Control Act.....	33
B.	USAC's Ownership by NECA Creates An Inherent Conflict In USAC's Audit Function.....	36
	CONCLUSION	37
	EXHIBIT LIST	39

SUMMARY

ILD Telecommunications Inc. ("ILD") and Intellicall Operator Services, Inc. ("Intellicall") seek review of: (a) the decision of the Universal Service Administrative Company ("USAC"), reflected in a USAC letter to Intellicall dated January 31, 2006, requiring Intellicall to refile its 2003 and 2004 FCC Form 499-A submissions; and (b) the audit report prepared by the USAC Internal Audit Division ("USAC-IAD") which formed the basis for USAC's decision to require refiling by Intellicall. During the course of the audit, USAC twice sought guidance from the FCC on specific issues that had arisen with respect to the audit. Although the Commission apparently has not provided the requested guidance, USAC-IAD completed the audit and prepared an audit report which apparently was approved by the Board of Directors of USAC on or about January 24, 2006. USAC's January 31 letter to Intellicall stated that the audit report formed the basis for USAC's decision to require refiling by Intellicall.

ILD and Intellicall seek review of certain procedural and substantive determinations made by USAC-IAD in conducting the audit and finalizing the report because those determinations exceeded the scope of USAC's authority and adversely affected ILD and Intellicall. Absent regulatory guidance from the Commission with respect to the conduct of contributor audits, USAC made demands, imposed deadlines, and made procedural, substantive and policy decisions during the course of the audit that adversely affect ILD and Intellicall. For example, USAC has not provided ILD or Intellicall with a copy of the final audit report, and there is no Commission rule requiring them to do so. The only audit report provided to ILD or Intellicall is dated months before the January 24, 2006 USAC Board

meeting at which the final audit report purportedly was approved and indicates on its face that it is a "draft." As a result, ILD is in the position of having to seek review of the decision requiring it to refile without having the opportunity to review the final audit report on which that decision was based. USAC also made unreasonable demands for representation letters and set unreasonable deadlines for responses to information requests during the course of the audit, but there are no FCC rules to address those issues.

In some cases, USAC also made substantive determinations or policy decisions during the course of the audit that are inconsistent with the statute, the rules, or the relevant reporting form or instructions (which are themselves at times internally inconsistent). In many cases, those determinations resulted in audit findings that would require ILD to include for USF contribution purposes revenues that: (a) are not derived from the provision of "telecommunications" services; (b) are derived from intrastate services; and/or (c) appear to be excluded under the relevant instruction or form. At the same time, ILD and Intellicall do not dispute that the audit report revealed certain errors by Intellicall that may require refile of the FCC Form 499-A submissions. In fact, USAC has acknowledged that the web of FCC rules, policies, and orders combined with USAC's own procedures, guidelines, instructions and reporting forms makes compliance with all applicable requirements "a challenging and complex endeavor," for USAC as well as program participants and contributors. However, ILD seeks review of the procedural and substantive issues identified herein, as well as the specific matters for which USAC sought guidance during the course of the audit, so that ILD can avoid the repeated refilings that may be required if all of these issues are resolved on a piecemeal basis.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Request for Review by)	CC Docket Nos. 96-45 and 97-21
ILD Telecommunications, Inc. and)	
Intellicall Operator Services, Inc.)	
)	
of Decision of the)	USAC Audit Report No. CR2004CP019
Universal Service Administrator)	
)	

REQUEST FOR REVIEW

ILD Telecommunications, Inc. ("ILD") and Intellicall Operator Services, Inc. ("Intellicall"), by counsel and pursuant to Sections 54.719 and 54.721 of the Commission's Rules, hereby request review of: (a) the Universal Service Administrative Company's ("USAC") decision to require Intellicall to refile its FCC Form 499-A submissions for 2003 and 2004;¹ and (b) an audit report prepared by the USAC Internal Audit Division ("USAC-IAD") and approved by USAC (Audit Report No. CR2004CP019), which formed the basis for USAC's decision to require refiling by Intellicall. The Commission should grant this request for review because USAC and USAC-IAD made inappropriate legal and policy decisions that: (a) exceed the scope of the authority granted to them; (b) violate the statutory directive to ensure that Universal Service Fund ("USF") contributions are based on "telecommunications" revenue and are "equitable and nondiscriminatory;" (c) require inclusion of intrastate revenues in the USF contribution base; (d) are inconsistent with the Commission's directive that USF

¹ The 2003 FCC Form 499-A refers to operating year 2002 and the 2004 Form refers to operating year 2003.

administration should be “competitively neutral;” and/or (e) are inconsistent with the relevant FCC Form and Instructions.

FACTUAL BACKGROUND

ILD is a privately owned provider of telecommunications, information and billing services. Among other services, it provides local exchange carrier (“LEC”) billing, direct billing, corporate calling cards, conferencing services, operator-assisted services, and long distance and international calling services. During the relevant time periods, it also provided certain prepaid calling cards and database services, but it has terminated nearly all of its prepaid card business. ILD sold its prepaid card business at the beginning of 2005 at a significant loss due largely to the highly competitive nature of the business and declining profit margins in part due to increasing USF obligations.

Intellicall is a wholly-owned subsidiary of ILD and holds various authorizations to provide telecommunications services. Intellicall prepared and submitted the FCC Form 499-A filings that are the subject of the USAC decision and the USAC-IAD audit. Nevertheless, the USAC-IAD audit report refers throughout to ILD rather than to Intellicall, and USAC has addressed relevant correspondence to Intellicall in some cases and to ILD in others. For convenience, Intellicall and ILD will be referred to collectively herein as “ILD,” except when referencing a particular communication to or from USAC.

Unlike many telecommunications providers that have completely ignored their responsibilities to the Universal Service Fund, Intellicall has paid millions to the Universal Service Fund since March 1998. However, by letter dated November 2, 2004, Intellicall received notice from USAC that USAC-IAD would “perform audit procedures on the data”

that Intellicall had submitted on FCC Form 499-A "to determine the adequacy of the process used to report revenue and other information" on that form and "to ensure the numbers are accurately stated" on the 2003 and 2004 forms. The letter also stated that a variety of data requests "were required to be completed" by Intellicall and sent to USAC in accordance with a timetable provided by USAC.² Finally, the letter stated that the USAC Internal Audit Division would "conduct an on-site visit" at the Intellicall location "where records are maintained and process owners supporting the FCC Form 499-A reporting are situated." A copy of the November 2, 2004 USAC letter is attached as Exhibit 1.

Intellicall provided the information demanded by USAC-IAD on January 5, 2005. Auditors from USAC-IAD spent several days at ILD's offices in Ponte Vedra Beach, Florida in January, 2005. In early February, 2005, USAC-IAD sought additional information, which ILD provided on February 11, 2005. Several months later, by email dated August 26, 2005, USAC-IAD provided ILD with ten "Detailed Exception Worksheets" ("DEWs") in which USAC-IAD took issue with ILD's accounting of various revenue segments and demanded that ILD respond in detail to the DEWs no later than September 9, 2005. *See* Exhibit 2. ILD requested additional time to respond, noting that USAC-IAD had taken more than 6 months to prepare the DEWs and that it would take more time to prepare a detailed response, particularly since one of the key staff people needed to prepare the response was out of the office due to the terminal illness of a family member. USAC-IAD agreed to give ILD five additional business days to respond to the DEWs, but no more.

² The timetable presented by USAC-IAD initially required Intellicall to return a completed questionnaire and to gather and provide information set forth in a "data collection template" within two weeks. *See* Exhibit 1 at 1 and Exhibits B and F. The time for responding to these requests eventually was extended by USAC-IAD.

ILD prepared and submitted its response to the DEWs on September 16, 2005, within the limited time afforded by USAC-IAD. See Exhibit 3. On January 24, 2006, ILD received one e-mail from USAC-IAD stating that the USAC Board of Directors had approved the final audit report that day and another e-mail stating that USAC-IAD had attempted to send the final audit report to ILD "last week." See Exhibit 4. Ultimately, USAC-IAD forwarded a copy of what purported to be the final audit report to ILD by e-mail on January 30, 2006, but the audit report attached to that email is dated October 31, 2005 and bears a "DRAFT" stamp across its final page. See Exhibit 5.

By letter dated January 30, 2006, USAC-IAD informed ILD that USAC had "completed the audit," but did not forward a copy of the final audit report. Instead, USAC-IAD enclosed a copy "of the representation letter that we would like to receive from you on ILD Telecommunications, Inc. letterhead ... via overnight mail ... by no later than February 7, 2006." Copies of the January 30, 2006 letter and the accompanying representation letter are included in Exhibit 6.

By letter dated January 31, 2006, the USAC Billing and Collection Department advised Intellicall that: (a) USAC-IAD "has completed the audit" of Intellicall; (b) "the audit final report detailing the findings was sent by IAD in a separate package;" (c) "as a result of the audit findings," the Billing and Collection Department had determined that Intellicall's revenues "are inaccurately reported on the FCC Form 499-A(s) presently on file for the years 2003/2004;" and (d) therefore, Intellicall "must revise its FCC 499-A revenue reports for these years" within 60 days of the date of the letter. The January 31 letter also stated that Intellicall "may appeal this action and the audit findings on which it is based" pursuant to 47 C.F.R.

Sections 54.719(c) and 54.720(a). A copy of the January 31, 2006 USAC letter to Intellicall is attached as Exhibit 7.

By letter dated March 2, 2006, the USAC Billing and Collection Department advised Intellicall that it had not yet received the revised Form 499-A filings required in its previous letter (which USAC stated had been sent “on February 1, 2006.”) The March 2, 2006 letter stated that if Intellicall did not “submit revised FCC Form 499(s) that adhere to the audit findings within 30 days, USAC will prepare FCC Form 499(s) on your behalf” and will “apply the appropriate contribution adjustment to the first USF invoices following expiration of the 30 day filing period.” *See* Exhibit 8 hereto. Finally, the letter again advised that Intellicall “may appeal this action and the audit findings on which it is based” pursuant to 47 C.F.R. §§ 54.719(c) and 54.7209(a). *Id.*

Contrary to the January 31 USAC letter, neither ILD nor Intellicall has ever received any separate package from USAC forwarding the final audit report. To date, the October 31, 2005 audit report accompanying USAC-IAD’s e-mail of January 30 (and bearing a “DRAFT” stamp) is the only audit report that has been provided to ILD and Intellicall.³ *See* Declaration of H. Edward Brooks (“Brooks Declaration”), a copy of which is attached as Exhibit 9, at ¶¶4-5. Among other things, that report states that in the opinion of USAC-IAD, Intellicall “was not compliant with the FCC regulations for the periods reviewed and the carrier revenues were not stated in accordance with the FCC Form 499-A Instructions in all material respects.” *Audit Report* at 3. Although ILD still has not been served with the final Audit Report, out of

³ Without waiving its right to receive and review the final audit report, for purposes of this Request for Review, ILD will refer herein to the October 31, 2005 “draft” report accompanying the January 30 e-mail as the “Audit Report.”

an abundance of caution, it is submitting this request for review in order to protect its right to have the Commission review the USAC actions at issue here.

ARGUMENT

USAC's administration of the federal universal service programs is, by its own admission, "a challenging and complex endeavor." *See* Comments of Universal Service Administration Company in WC Docket No. 95-195, filed Oct. 18, 2005 ("*USAC Comments*") at 12. Since 1998, USAC has administered the collection and disbursement of more than \$35 billion pursuant to a complex and continually evolving web of FCC regulations, FCC orders and policies, and various filing procedures, forms and instructions and other USAC operating procedures. The Commission has stated that USAC's role in this process is "exclusively administrative." Consequently, USAC "may not make policy, interpret unclear provisions of the statute or rules or create the equivalent of new guidelines, or interpret the intent of Congress," and that if "the Act or the Commission's rules are unclear, or do not address a particular situation, USAC must seek guidance from the Commission on how to proceed." *See* 47 C.F.R. §54.704; *see also* *Changes to the Board of Directors of the National Exchange Carrier Ass'n., Inc.* (Third Report and Order), 13 FCC Rcd 25058 (1998) at ¶16. However, USAC has acknowledged that such "guidance from the Commission" is not always available immediately and that its administration of the USF programs would benefit from further clarity regarding the distinction between: (a) "administrative matters entrusted to USAC and policy decisions requiring Commission or staff action;" and (b) as to the latter, "what policy matters need to be addressed by formal rules or orders and what matters rest with the Commission staff to provide guidance to USAC." *See* USAC Comments at 13-14, 43-44, 50.

The Commission has delegated to USAC the task of billing and collecting the USF “contributions” made by telecommunications carriers. 47 C.F.R. §54.702(b). The Commission’s rules also state that USAC “shall have the authority to audit contributors and carriers reporting data to the administrator.” See 47 C.F.R. §54.707. However, other than the general requirement to follow generally accepted government auditing standards contained in 47 C.F.R. §54.702(n), the Commission has provided no guidance on the procedures by which contributor audits should occur.⁴ Consequently, as set forth more fully below, certain audit procedures and procedural deadlines are formulated unilaterally by USAC on an *ad hoc* basis.⁵ In addition, USAC has been required to make substantive decisions in the course of conducting the audit that necessarily involve the interpretation of statutes and FCC regulations, without the required guidance from the FCC.⁶

⁴ See, e.g. *FCC Office of Inspector General, Memorandum to FCC Chairman and Managing Director*, November 10, 2005 at 1 (FCC has “not fully considered or developed an approach to ensure compliance with contributor revenue requirements”). With respect to beneficiary audits, the Commission determined in 2004 that “a standardized uniform process for resolving audit findings was necessary” and it directed USAC to submit a proposal for resolving beneficiary audit findings. USAC submitted a proposed audit resolution plan in October 2004, and the Commission solicited public comment on that plan in December 2004. However, no decision has been issued by the Commission, and no similar process has occurred with respect to contributor audits. See, e.g., *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-Up, Changes to the Board of Directors of National Exchange Carrier Association, Inc.*, WC Docket No. 05-195, CC Docket No. 96-45, CC Docket 02-6, WC Docket No. 02-60, WC Docket No. 03-109, CC Docket No. 97-21, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 05-124, 70 FR 41658 (rel. June 14, 2005) (“*USAC NPRM*”) at ¶¶68-69 (seeking comment on what standards should be imposed for carrying out beneficiary audits and whether and when audit reports should be provided to the audited entities).

⁵ USAC specifically identified procedural “deadlines established by USAC” as one of “the types of procedures amenable to codification” by the Commission. See *USAC Comments* at 80.

⁶ For example, in the 14 month process of the ILD audit, USAC-IAD referred at least two substantive issues to the FCC for further guidance. On or about February 16, 2005, USAC sought guidance on how to treat prepaid cards sold to wholesalers and distributors where the card provider does not control or even know the price actually paid by the end-user customer for the card. On or about November 4, 2005, USAC also apparently sought guidance on how to treat “carriers who report revenues based on revenue recognition principles in accordance with GAAP” because these revenues often differ from “gross billed revenues” as defined in the

USAC has recognized that the evolving web of regulations, policies, guidelines, operating procedures and instructions for completing forms presents challenges to contributors and other USF participants as well. Among other things, "program participants need to review a variety of sources in order to understand fully the requirements applicable to them" because those requirements are not set forth clearly in any one place. *See USAC Comments* at 80. Aside from the statute and FCC regulations and orders, USAC has "developed detailed operating procedures" for USF support mechanisms and contributions, and has stated that "there are hundreds of procedures, they change frequently, and many must remain confidential in order to secure program integrity." *Id.* at 81-82. Although USAC "provides guidance about many aspects of the USF programs and contribution requirements on its website, [and] in the instructions for the various forms," those instructions are sometimes internally inconsistent, conflict in some respects with the applicable statute, regulation or FCC form, and change periodically as well.

Many of the audit findings with respect to ILD highlight ambiguities or inconsistencies within the tangled and ever-changing web of FCC rules, orders and policies, USAC operating procedures, guidelines and reporting forms and instructions. In some cases, the audit process confirmed that ILD had misinterpreted the relevant requirement or used the wrong information in completing the FCC Form 499-As, and in those cases ILD has concurred with the audit findings and acknowledges that refileing may be required. However, in other cases, USAC overstepped its bounds, failed to request guidance from the Commission, or indicated that it was powerless to address a substantive issue raised by ILD. ILD now seeks Commission

instructions to FCC Form 499-A. *See Audit Report* at 2.n.1, 5 and 6. To date, no such guidance has been forthcoming.

review of those matters in order to avoid multiple refiling requirements that may result from the piecemeal resolution of these matters.

I. Certain USAC Audit Procedures Are Inconsistent With FCC Rules And Violate Administrative Due Process

Neither the Communications Act nor the FCC's rules set forth the procedures for conducting contributor audits. Other than requiring USAC to use generally accepted government accounting standards, the Commission has not published any guidelines for USAC or audited parties to follow. There is no programmatic agreement, memorandum of understanding, or other contract in place between the FCC and USAC setting forth procedures for, and limitations on, contributor audits to be conducted by the USAC-IAD. As a result, USAC essentially makes up the rules during the course of the audit process, and there is nowhere for the auditee to turn to determine whether those rules are reasonable or appropriate.

A. USAC Still Has Not Served Intellicall with a Copy of the Final Audit Report

The arbitrary and capricious nature of the procedures used by USAC during the contributor audit process is evidenced by the fact that ILD currently is in the untenable position of seeking review of a final audit report that it has never seen. *See* Brooks Declaration at ¶5. There simply is no rule anywhere requiring USAC to provide ILD (or any other contributor that is the subject of a USAC audit) with a copy of the final audit report. *See, e.g. USAC NPRM* at ¶68 (questioning whether the Commission should adopt a rule requiring USAC to provide audit reports to the audited entities within a specified time). USAC has stated that it “generally provides auditees with a copy of the final audit report within 30 days of the audit being deemed final and accepted by the USAC Board of Directors.” *See USAC Comments* at 212. However, as set forth above, ILD still has not received a copy of the final audit report,

despite the fact that the audit report apparently was approved by the USAC Board in January and the findings in that report clearly formed the basis for action taken by USAC requiring refilings by Intellicall.

By letter dated January 31, 2006, the USAC Billing and Collections Department advised Intellicall that it had “determined that Intellicall...revenues are inaccurately reported on FCC Form 499-A” for 2003 and 2004 and that Intellicall “must revise its FCC 499-A revenue reports for these years.” That letter also stated that Intellicall “may appeal this action *and the audit findings on which it is based*” and that “the audit final report detailing the findings was sent by IAD in a separate package.” *See Exhibit 7 hereto (emphasis added).* However, ILD never received any separate package and has been forced to file this request for review in response to the January 31, 2006 letter from USAC without having the opportunity to review the final audit report upon which that letter was based.⁷

B. USAC Demanded Representation Letters From Intellicall That Were Inaccurate and Improper.

Included as an Exhibit to USAC-IAD’s letter of November 2, 2004 was a “Contributor Representation Letter,” which USAC-IAD stated that it would require ILD to sign at the conclusion of USAC-IAD’s field work. *See Exhibit 1 at Exhibits D and F.* By letter dated January 30, 2006, USAC-IAD again demanded a similar representation letter. The January 30, 2006 USAC-IAD letter advised Intellicall that USAC-IAD had “completed the audit of the 2003 and 2004 FCC Form 499-A filings.” *See Exhibit 6 hereto.* Although that letter did not

⁷ Intellicall did receive an email from USAC-IAD on January 30, 2006 attaching what purported to be the final audit report approved by the USAC Board at its meeting on January 24, 2006. However, the audit report attached to that email was dated October 31, 2005 and still bore a “DRAFT” stamp on its final page. *See Exhibit 5, hereto.* In any event, FCC rules do not provide for service of documents by email. *See 47 C.F.R. §1.47.*

include a copy of the final audit report, USAC-IAD enclosed the “representation letter” and stated that USAC-IAD “would like to receive” that letter, executed and on ILD letterhead, “no later than February 7, 2006.” There is no provision for such a “representation letter” anywhere in the statute or in the FCC’s rules, and certainly no provision requiring a response to such a demand in only 5 business days.⁸

In any event, the substance of the representation letter demanded by USAC clearly was improper as well. At the outset, the letter demanded by USAC indicated that it was being provided by Intellicall “in connection with Universal Service Administrative Company (“USAC”) engagement to perform an audit, to assist in determining the accuracy and adequacy of prepaid calling card revenues and other information” provided by ILD. Clearly, ILD did not “engage” USAC to perform the audit. Moreover, USAC-IAD demanded that Intellicall represent, among other things, that its management had “disclosed any communications from regulatory agencies, internal auditors, *and other practitioners* covering *possible* noncompliance with the accuracy of revenues and other information, reported on ILD Telecommunications, Inc.’s FCC Form 499-A for Years 2003 and 2004, including communications received through the date of this letter.” *See* Exhibit 6 (emphasis added).

At face value, the representations demanded by USAC would require ILD to waive attorney-client privilege and disclose the substance of any communications with “other practitioners,” including counsel (both in-house and outside counsel) as well as any third party “practitioners” retained by counsel on their behalf to assist in rendering legal advice to ILD.

⁸ The shortest time period under the FCC’s general pleading rules is 5 days for a reply, but that period does not include intervening weekends and holidays, and an additional three days to account for work delays are added to that period. *See, e.g.* 47 C.F.R. §§1.4 and 1.45. Thus, even if USAC-IAD’s demand was substantively proper, the deadline set by USAC-IAD clearly was inconsistent with the FCC’s rules.

Nowhere does the Communications Act or the Commission's rules bestow upon USAC the *authority to require a carrier and its management to waive their rights to confer with counsel and "other practitioners."* Without proper guidance and oversight by the Commission, USAC-IAD simply made up the rules as it went along, including making demands upon ILD that were procedurally and substantively improper.

C. USAC Unilaterally Established Artificial Deadlines During the Audit Process

During the course of the audit process, USAC on several occasions demanded information from ILD and set unilateral and artificial deadlines for ILD's responses. USAC initially advised Intellicall that it would be "perform[ing] audit procedures" on the data submitted by Intellicall in a letter from USAC-IAD dated November 2, 2004. That letter included a number of exhibits seeking additional data from Intellicall and stated that the "data requests are required to be completed by Intellicall Operator Systems and sent to USAC based on the *Project Timetable*" set forth in Exhibit F to the letter. *See* Exhibit 1 (emphasis in original). Among other things, the exhibits included a questionnaire and a "detailed list of items requested from the contributor." The letter also purported to include "templates" setting forth the "format for documenting items" requested by USAC, but certain of the templates were not included with the letter. The "Project Timetable" initially required that all of the information requested by USAC be gathered and provided to USAC by November 17, 2004. *See* Exhibit 1 at Exhibit F. Even assuming that the information request was appropriate under Section 54.711 of the Rules, the response deadline unilaterally imposed by USAC was

unreasonable, and there is no Commission rule requiring USAC to provide a reasonable response time.⁹

After ILD had responded to the data requests, USAC-IAD conducted field work for several days at ILD's headquarters in Ponte Vedra, Florida. Months later, on August 25, 2005, USAC forwarded no fewer than ten DEWs to ILD and demanded ILD's detailed response to the DEWs by no later than September 9, 2005. Despite the unavailability of a key staff person, USAC refused to extend the response time by any more than five business days. See Brooks Declaration at ¶6. While ILD appreciated the opportunity to provide responses to the DEWs, its ability to do so was limited by the time-frame unilaterally imposed by USAC -- with no rules, guidelines or other publicly available procedures to serve as a check on the reasonableness of the USAC demands.

II. USAC-IAD Made Improper Substantive Interpretations And Policy Decisions In Conducting The Audit.

The Commission has stated that in performing its administrative functions, USAC "may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress." 47 C.F.R. §54.702(c). Instead, "where the Act or the Commission's rules are unclear, or do not address a particular situation, the Administrator *shall seek guidance from the Commission.*" *Id.* (emphasis added). In the case of the ILD audit, USAC twice sought, but did not receive, guidance from the Commission. Nevertheless, USAC-IAD proceeded with the audit, finalized the audit report and had it approved by the USAC Board. Because the

⁹ Ultimately, USAC agreed to extend the time for responding to the data requests, but the episode highlights USAC's ad hoc determination of the applicable procedures and deadlines at each step in the audit process. USAC has stated that the Commission needs to adopt rules to clearly delineate "the sanctions for failing to comply with document requests" relating to an audit. See *USAC Comments* at 233. However, the Commission also must include in any such rules provisions to insure that document demands are appropriate in scope and that deadlines for the auditee's response are reasonable. No such rules currently exist.

Commission has provided no guidance to USAC in response to the specific requests, or with respect to the conduct of contributor audits in general, USAC of necessity has engaged in improper statutory and rule interpretations and policy-making in conducting the audit of ILD.

A. USAC-IAD Audited ILD Without Receiving The Guidance It Sought From The FCC.

At the outset, USAC-IAD recognized that ILD was not required to, and did not, keep its financial records in accordance with the FCC ARMIS Uniform System of Accounts (“USOA”). *See* Exhibit 1 at Exhibit A, Question 5 and ILD Response. Instead, ILD reports revenues on an accrual basis based on generally accepted accounting principles (“GAAP”) with respect to revenue recognition. *See* Brooks Declaration at ¶8. Recognizing that carriers using GAAP accounting will often report revenues that “differ from” the “gross billed revenues” identified in the instructions to FCC Form 499-A, USAC-IAD “sought guidance from the Commission” on or about November 4, 2005 with respect to how to treat those carriers. *See Audit Report at 2 n.1.* The Commission apparently has not yet provided guidance on those issues. Nevertheless, USAC-IAD has determined that, in the absence of such guidance from the Commission, it “will audit carrier’s Form 499-A based on revenues reported in the carrier’s general ledger and financial statements.” *Id.* As reflected in various portions of the Audit Report, that determination required USAC to make numerous rule and policy interpretations in the context of reconciling ILD’s GAAP-based accrual accounting with the relevant FCC Forms and Instructions. ILD respectfully suggests that USAC-IAD, having sought but not yet received FCC guidance on these issues, had no authority to finalize the audit report with respect to ILD and then to order Intellicall to resubmit its FCC Form 499-A filings on the basis of that audit report.

ILD's use of accrual accounting consistent with GAAP principles, along with discrepancies between the Instructions to FCC Form 499-A and the Form itself, affected the way in which ILD accounted for certain revenues. These factors also affected the audit findings with respect to whether those revenues complied with the instructions to FCC Form 499-A. For example, GAAP accounting principles require that ILD recognize revenues from the sale of prepaid cards as the cards are used. *See Audit Report* at 5. As a result, ILD creates "deferred revenue accounts" with respect to prepaid card sales and recognizes the revenue only as the cards are used. However, USAC-IAD indicated that all of these revenues should be reported in Line 411 as end user revenues upon sale of the card. *Id.* at 6.

In addition to the timing issues with respect to revenue recognition, the FCC Form and Instructions are inconsistent with respect to where prepaid revenues should be reported on the Form. The FCC Form 499-A indicated that reseller revenues are to be included in Block 3 of the Form. The Form also states that the carrier should report in Line 411 of the Form revenues from "Pre-paid calling card (including card sales to customers and *non-carrier* distributors) reported at face value of the cards." *See FCC Form 499-A Line 411* (emphasis added). Consequently, ILD reported revenues from prepaid card sales to wholesalers in Block 3 of the Form.

Consistent with what the actual form says, the Instructions to FCC Form 499-A state that Line 411 should include "revenues from prepaid cards *provided either to customers or to retail establishments*" and that the amounts reported on Line 411 "should represent the amounts actually paid by customers *and not the amounts paid by distributors or retailers.*" *See, e.g. 2003 Instructions* at 20; *2004 Instructions* at 24. However, the Instructions also state that prepaid card revenues should be "classified as end-user revenues." As a result, USAC-

IAD determined that all prepaid card revenues should have been reported in Line 411 as end user revenues. *See Audit Report* at 9.

The conflicts among GAAP revenue recognition principles, the Instructions to FCC Form 499-A, and the Form itself have other real-world implications in terms of the recognition of revenue. For example, many of the prepaid cards provided by ILD were sold to distributors and retail establishments that used them as promotional give-aways. Thus, "the amount actually paid" by the end-user customer was \$0. Other cards were stolen or sold by retailers at a discount. The point is that ILD does not know what the end-user customer actually paid for the card. *See Brooks Declaration* at ¶9. Instead, ILD booked revenue from the sale of those cards to the distributors or retail establishments as the end-user customers (who may have paid nothing for them) used the minutes on those cards. ILD treated cards sold to end users (rather than given away) by distributors and retailers the same way. As a result, ILD recognized the "telecommunications" revenues as the cards were used to place calls,¹⁰ but treated other revenues such as computer database maintenance fees and "breakage" (unused time remaining on a card at its expiration) as non-telecommunications revenue.

Without receiving any guidance from the Commission, USAC-IAD unilaterally decided to: (a) take all of the outstanding deferred revenue accounts and treat them as gross revenues; (b) make certain allocations of revenues between prepaid card and other prepaid revenues; and (c) use ILD reports of other traffic as a surrogate to determine the interstate and international percentages of the prepaid card traffic. *See Audit Report* at 5-6. The result is that all of the prepaid card revenue "deferred" under GAAP was treated by USAC as being recognized as

¹⁰ ILD treated "prepaid" revenue from other wholesalers the same way, recognizing telecommunications revenue as the telecommunications services were used.

end-user telecommunications revenue immediately upon sale of the card, when a substantial portion of that revenue had not yet been realized and/or was unrelated to any "telecommunications" service. By making those determinations and the adverse audit findings that resulted from those determinations, and then directing ILD to take action based on the audit findings, USAC and USAC-IAD have unilaterally made and applied the very policy determinations for which they sought, but have not yet received, guidance from the Commission. In doing so, they have exceeded the scope of the authority granted under Sections 54.702 and 54.707 of the rules.

B. The Instructions to Form 499-A And USAC-IAD's Interpretation of Them Discriminate Against Carriers Using Accrual Accounting.

Section 254(b)(4) of the Communications Act states that all "providers of telecommunications services should make an *equitable and nondiscriminatory* contribution to the preservation and advancement of universal service" (emphasis added). Likewise, Section 254(d) states that "every telecommunications carrier that provides interstate telecommunications services shall contribute, *on an equitable and non-discriminatory basis* to the specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service" (emphasis added). Moreover, Section 54.701 of the Commission's rules states that USF support mechanisms should be "competitively neutral." Despite these admonitions, USAC-IAD has interpreted the USF contribution obligations in a manner that obviously discriminates against telecommunications service providers that use GAAP accounting and report revenues on an accrual basis.

1. Disparate Treatment of Bad Debt

For example, beginning in 2004, the instructions to FCC Form 499-A expressly allowed for the deduction of bad debt. *See* 2004 Instructions to FCC Form 499-A, Exhibit 10 hereto, at 20. USAC-IAD allowed ILD's bad debt deduction on the 2004 Form, but disallowed the same deduction on the 2003 Form, because the Instructions for the 2003 form did not explicitly permit bad debt deductions. *See Audit Report at 12, 25-27.* This approach clearly discriminates against carriers using the accrual method of accounting by including in "gross billed revenues" amounts that the carrier billed but never received, without affording any offset for bad debt. As a result, the accrual-based carrier that is denied a deduction for bad debt on the 2003 Form makes USF "contributions" based on "revenues" that it never received, while cash-based carriers report as "gross billed revenues" and make USF contributions on only those revenues actually received. Such disparate treatment clearly contravenes the statutory directive that such contributions be "equitable and nondiscriminatory" as well as the Commission's rule that USF support mechanisms be "competitively neutral."¹¹

2. Disparate Treatment of Prompt Payment Discounts

USAC's treatment of discounts provided to customers for prompt payment also discriminates against carriers using accrual-based accounting. Just as some carriers impose late payment fees and penalties, ILD provided certain customers with contractual discounts in return for prompt payment by the customer. *See* Brooks Declaration at ¶10. Cash-based

¹¹ Intellicall raised this issue in its responses to the USAC-IAD DEWs, but neither USAC-IAD nor USAC Financial Operations Management ("USAC-FOM") addressed this issue in their responses. *See Audit Report at 27.* To the extent that USAC maintains that this is a matter for resolution by the FCC, ILD respectfully requests that such bad debt allowance be permitted for 2003 as well as 2004.

carriers would book only the amount of the discounted revenue actually received. However, USAC has disallowed ILT's deduction of the applicable discounts for prompt payment, even though ILT never was paid the non-discounted portion of the amounts billed. See *Audit Report* at 4-11. As a result, ILT and other accrual-based carriers are assessed USF contributions based on "revenues" they never received, while cash-based carriers are not. Moreover, USAC does not include revenue actually received from late fees and penalties as "telecommunications" revenues for USF contribution purposes, but does assess USF obligations based on discounted fees that never were received because the customer took advantage of the prompt payment discount. See, e.g. 2004 Instructions at 23 (including "late payment charges and charges (penalties)" on Line 418 as "revenues that should not be reported in the contribution bases").

C. USAC-ILT's Interpretations Require Intellicall to Contribute to USF on the Basis of Non-Telecommunications and Intrastate Revenues.

In the Audit Report, USAC-ILT has made several findings, the effect of which is to include in ILT's revenue base for purposes of calculating its USF contribution obligations, revenues derived from providing services other than telecommunications services and/or revenues that properly should be classified as intrastate. Section 254(b)(4) requires USF contributions from "providers of *telecommunications* services." Section 54.709 of the Commission's rules states that prior to April 2003, "contributions to the universal service support mechanisms shall be based on contributors' end-user *telecommunications* revenues" and, more specifically, on the contributors' "interstate and international revenues derived from domestic end users for *telecommunications or telecommunications services*." 47 C.F.R. §54.709(a) (emphasis added). For purposes of these rules, "telecommunications" is defined as

"the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 C.F.R. §54.5. Likewise, "telecommunications service" is defined as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to the effectively available to the public, regardless of the facilities used." *Id.*

1. Computer Data Storage And Maintenance

Among the services previously offered by Intellicall were prepaid calling cards and database services. Revenues from prepaid card sales include revenues for certain services other than telecommunications services. For example, prepaid card revenue includes revenue from per-call "service fees" and from time based maintenance charges, which are assessed for services provided by ILD for inputting, maintaining and updating information in ILD computer databases with respect to those cards, including recharges. *See*, sample cards attached as Exhibit 11 hereto. The charges are based on the storage and updating of data on ILD's computer facilities, not "the transmission, between or among points specified by the user, of information of the user's choosing," and certainly not for the interstate or international transmission of the customer's information. The revenue from the "telecommunications" services is recognized as the cards are used to place calls. However, the database services are used regardless of whether the card is ever used to place a call.

USAC-IAD determined that the revenues for such computer database services "are not an allowable deduction in Line 411 of FCC Form 499-A and must be included in the revenue reported." *See Audit Report* at 4. That determination is contrary to the intent of Section 254 of the statute, to Section 54.709 of the Commission's rules, and to the instructions to Form